

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

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### Legend

Employer =  
Trust =  
Plan =  
State =  
Members =

Dear :

This letter responds to a letter from your authorized representatives dated May 9, 2012, submitted on behalf of the Employer, requesting rulings that (1) the Trust's income is excludable from gross income under Internal Revenue Code (IRC) § 115, and (2) the Trust is not required by IRC § 6012(a)(4) to file a federal income tax return. The Employer represents the facts as follows.

### FACTS

The Employer is a political subdivision of State. It intends to establish the Trust to fund a health and welfare plan providing post-employment health care benefits or medical insurance coverage for eligible retirees.

The assets of the Trust consist solely of contributions from the Employer and the derivative earnings. No contributions will be made to the Trust by employees, former employees, or other employers. Retirees of the Employer, their spouses and eligible dependents, will be the exclusive beneficiaries of the Trust. The Trust will be used

solely to pay for the retiree health care benefits or medical insurance coverage provided under the Plan, as well as to cover the reasonable administrative expenses of the Trust.

The Trust is governed by the Board of Trustees (the Board), comprised of the Members. Each Member's term of service ends when his term of office or employment ends. The Board holds all powers necessary to carry out the purpose of the Trust, including the investment, management, protection, and control of the assets of the Trust.

The Board of Trustees may amend or terminate the Trust if circumstances change, if the purposes of the Trust can no longer be accomplished, or if necessary to conform to legal requirements.

The Trust will terminate if the Plan is terminated or discontinued, such that the funding of benefits under the Plan is no longer needed. Any assets of the Trust remaining after termination will be distributed to the Employer or its designee, which shall be State, a political subdivision of State, or an entity the income of which is excluded from gross income under IRC § 115(1).

#### LAW & ANALYSIS – Ruling Request 1

IRC § 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income generated by an investment fund that is established by a state to hold revenues in excess of the amounts needed to meet current expenses is excludable from gross income under IRC § 115(1), because such investment constitutes an essential governmental function. The ruling explains that the statutory exclusion is intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of an entity engaged in the operation of a public utility or the performance of some governmental function that accrues to either a state or political subdivision of a state. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and that are within the ambit of a sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, holds that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (e.g., casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under IRC § 115(1), because the organization is performing an essential governmental function. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

The Trust will fund health care benefits and medical insurance coverage for retired employees and their eligible dependents. Providing health and welfare benefits to former public employees constitutes the performance of an essential governmental function within the meaning of IRC § 115(1). See Rev. Rul. 77-261 and Rev. Rul. 90-74.

The income of the Trust will accrue to the Employer, a political subdivision of State. No private interests will participate in, or benefit from, the operation of the Trust, other than as providers of goods or services. The dedication of the assets of the Trust for the exclusive benefit of retiree participants and their spouses and eligible dependents will satisfy an obligation of the Employer to provide health and welfare benefits to its retired employees. The benefit to retirees of the Employer will be incidental to the public benefit. Upon dissolution, no Trust assets will be distributed to an entity other than a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under IRC § 115. See Rev. Rul. 90-74.

#### LAW & ANALYSIS – Ruling Request 2

Section 301.7701-1(b) of the Procedure and Administration Regulations provides that the classification of organizations that are recognized as separate entities is determined under Treas. Reg. §§ 301.7701-2 through -4, unless a provision of the Code provides for special treatment of that organization.

Treas. Reg. § 301.7701-4(a) provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Contributions to the Trust are to be used to pay retiree health benefits for eligible retired employees and their spouses and eligible dependents. The Board of Trustees is charged with the responsibility of protecting and conserving Trust property for the benefit of the beneficiaries of the Trust. The beneficiaries of the Trust cannot share in the discharge of the Board's responsibility for the protection and conservation of property and, therefore, are not associates in a joint enterprise for the conduct of business for profit. Assuming that the Trust is recognized as a separate entity under Treas. Reg. § 301.7701-1, we conclude that the Trust is an ordinary trust under Treas. Reg. § 301.7701-4(a).

IRC § 6012(a)(4) provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

#### CONCLUSIONS

Based solely on the facts and representations submitted on behalf of the Employer, we conclude that:

1. Because the income of the Trust will derive from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof, the Trust's income will be excludable from gross income under IRC § 115(1).
2. The Trust will be classified as a trust within the meaning of IRC § 7701(a) and Treas. Reg. § 301.7701-4(a). Because the income of the Trust will be excludable from gross income under § 115(1), the Trust will not be required by § 6012(a)(4) to file an annual income tax return.

No opinion is expressed concerning the federal tax consequences under any IRC provision other than the one specifically cited above. This ruling concerns only the federal tax treatment of the Trust's income and may not be cited or relied upon as to any matter relating to the taxation of accident or health contributions or benefits. In particular, no opinion is expressed regarding whether contributions or premiums paid on behalf of, or benefits received by, employees, former employees, retirees, spouses, dependents, or others will or will not be taxable.

Except as explicitly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer who requested it. IRC § 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, your authorized representative will receive a copy of this letter.

Sincerely,

Kenneth M. Griffin  
Chief, Exempt Organizations Branch  
(Tax Exempt & Government Entities)

Enclosure (1)

cc: